

Multilateral CSA Notice 45-312

Proposed Prospectus Exemption for Distributions to Existing Security Holders

November 21, 2013

Introduction

The securities regulatory authorities in British Columbia, Alberta, Saskatchewan, Manitoba, Québec, New Brunswick, Nova Scotia, Prince Edward Island, Yukon, Northwest Territories and Nunavut (the participating jurisdictions or we) are publishing for comment a substantially harmonized proposed prospectus exemption (proposed exemption) that would, subject to certain conditions, allow issuers listed on the TSX Venture Exchange (TSXV) to raise money by distributing securities to their existing security holders.

This notice summarizes the terms of the proposed exemption and includes a request for comment.

Background

Prospectus distributions and prospectus exempt distributions

One of the main requirements of securities legislation is that an issuer distributing a security must file and obtain a receipt for a prospectus. The prospectus must contain full, true and plain disclosure of all material facts relating to the securities being offered. Investors who purchase securities under a prospectus are provided certain statutory rights.

Where alternative protection exists, securities legislation provides exemptions from the prospectus requirement.

The most commonly used prospectus exemption is the accredited investor exemption. The accredited investor exemption is available for the sale of securities to both new investors and existing security holders provided that they meet the definition of “accredited investor”. If an issuer wants to raise money from investors who are not accredited investors (retail investors), without a prospectus, the principal prospectus exemptions available include:

- offering memorandum;
- rights offering; and
- TSXV short form offering document.

Our data shows that TSXV issuers do not generally use any of these exemptions to raise capital from retail investors. Our data also shows that, after the initial public offering, TSXV issuers rarely conduct prospectus offerings.

Market participants report that TSXV issuers are not conducting prospectus offerings or using prospectus exemptions to sell to retail investors because of the time and cost involved in preparing the required offering document. This is exacerbated by the risk of a failed financing –

they must incur significant up-front costs that are payable regardless of the success of the financing.

This means that retail investors that want to invest in these issuers must generally buy their securities on the secondary market.

Retail investors

Because TSXV issuers rarely conduct prospectus offerings or use the prospectus exemptions intended for sales to retail investors, retail security holders have limited opportunity to invest directly in TSXV issuers.

This means retail investors:

- must pay market price instead of the discounted price typically available in private placements to accredited investors;
- must pay brokerage commissions; and
- are unable to acquire the warrant “sweeteners” typically issued with shares in private placements to accredited investors.

This also means that TSXV issuers do not have access to a potential source of capital.

Proposal

We have received submissions and comments from a number of market participants asking us to consider a new prospectus exemption to facilitate capital raising, particularly by TSXV issuers.

Because they are reporting issuers, TSXV issuers must comply with both continuous disclosure obligations and insider trading prohibitions under applicable securities legislation. As listed companies, they are also subject to disclosure and other obligations and restrictions under the TSXV’s Corporate Finance Manual. Currently, retail investors can buy an unlimited number of securities of TSXV issuers on the secondary market, without any additional disclosure.

In developing the proposal, we considered the submissions and similar prospectus exemptions available in other jurisdictions, in particular Australia.

The proposed exemption

We are proposing a new prospectus exemption with the following key conditions:

- the issuer must have a class of equity securities listed on the TSXV;
- the issuer must have filed all timely and periodic disclosure documents as required under applicable securities laws;
- the offering can consist only of the class of equity securities listed on the TSXV or units consisting of the listed security and a warrant to acquire the listed security;
- the issuer must issue a news release disclosing the proposed offering, including details of the use of proceeds;

- each investor must confirm in writing to the issuer that as at the “record date” the investor held the type of listed security that the investor is acquiring under the proposed exemption;
- unless the investor has obtained advice regarding the suitability of the investment from a registered investment dealer, the aggregate amount invested by the investor in the last 12 months under the proposed exemption is not more than \$15,000;
- an investor must be provided with certain rights of action in the event of a misrepresentation in the issuer’s continuous disclosure record; and
- although an offering document is not required, if an issuer voluntarily provides one, an investor will have certain rights of action in the event of a misrepresentation in it.

We propose that the first trade of securities issued under the proposed exemption will be subject to resale restrictions under section 2.5 of National Instrument 45-102 *Resale of Securities* like most other capital raising prospectus exemptions. In addition, issuers will have to file a report of exempt distribution within 10 days after each distribution under the proposed exemption.

This is only an exemption from the prospectus requirement. There is no corresponding exemption from the dealer registration requirement.

Investor protection considerations

Disclosure document

Currently, a distribution of securities to retail investors requires a prospectus or other disclosure document. If the issuer is a reporting issuer, the disclosure document is typically short, incorporating by reference the continuous disclosure documents that have been filed by the reporting issuer and providing certain supplementary disclosure relating to the distribution.

In the case of a prospectus, the supplementary disclosure is the short form prospectus, which must include any additional information necessary to ensure the issuer has made “full, true and plain disclosure of all material facts”. In the case of a prospectus-exempt rights offering or an offering memorandum prepared under the offering memorandum prospectus exemption, the supplementary disclosure must not contain a misrepresentation.

Under the proposed exemption, an issuer is not required to provide prospective investors with a supplementary disclosure document, other than an offering news release.

We considered whether it is necessary to require a supplementary disclosure document. We think that the issuer’s continuous disclosure obligations under securities legislation, as supplemented by its obligations under the TSXV Corporate Finance Manual, will provide investors with sufficient information on which to base an investment decision.

In addition, we are proposing requiring the issuer to represent to prospective purchasers in the subscription agreement that there are no material facts or material changes relating to the issuer that have not been generally disclosed. This will reinforce the goal of statutory insider trading prohibitions.

Ability to withstand loss

Under the exemption, an existing security holder could invest up to \$15,000, which limits the investor's potential loss. However, we recognize that retail investors can invest whatever amount they decide on the secondary market. For this reason, and because, in certain circumstances, an investment above \$15,000 may be suitable for an existing retail security holder, the proposed exemption contemplates that an investor may invest more than \$15,000 if they receive suitability advice from a registered investment dealer.

Protection afforded by being an existing shareholder

Another assumption underlying the proposed exemption is that being an existing security holder provides a form of investor protection. Being a security holder indicates that the investor has previously made an investment decision about the issuer. This suggests that the investor has some familiarity with the issuer, including its trading record and its continuous disclosure. Further, if an investor is an existing security holder, we may generally assume that the investor has at least some limited investing experience.

Record date

The record date is the date on which a security holder must already hold securities of the TSXV issuer in order to be eligible to acquire securities under the proposed exemption. The record date will be prior to the date of the announcement of the offering. We are currently considering what would be the appropriate record date.

One alternative is to set the record date up to one day before announcement of the offering. As the proposed exemption requires that the investor already be a security holder, the investor will have already considered whatever information or advice they needed to make an investment decision. There is no reason to differentiate between a security holder that bought the securities one day before the announcement of the offering and a security holder that bought the securities some longer period before the announcement of the offering.

A second alternative is to set the record date some longer period before announcement of the offering. We are considering whether there is any added protection in requiring that an investor be a security holder for a period of time longer than one day. Possibly, this could indicate the security holder has more familiarity with the issuer, its disclosure and trading record. We have queried whether a longer period might reduce the risk of a "pump and dump" where high pressure sales tactics could be used to solicit new unsophisticated investors to buy a small number of securities in the secondary market on day one, then enabling the issuer to sell them \$15,000 under the proposed exemption on the next day.

Implementation by blanket order or rule

The participating jurisdictions, other than the Alberta Securities Commission (ASC), the Autorité des marchés financiers (AMF) and the Financial and Consumer Services Commission (New

Brunswick) (FCNB), intend to adopt the proposed exemption by way of a blanket order. The ASC, AMF and FCNB contemplate adopting the proposed exemption by local rule. The proposed exemption is substantially harmonized between the jurisdictions but there are a few differences as described below.

Statutory rights of action for misrepresentation in continuous disclosure

By proposing to adopt the proposed exemption as a rule, the ASC, AMF and FCNB can specify that the statutory secondary market civil liability provisions apply to an investor investing under the proposed exemption. Because the other participating jurisdictions are proposing to adopt the exemption by way of a blanket order, they cannot make this specification. As an interim measure until they decide whether to propose a rule, those jurisdictions propose to require that a contractual right of action for rescission or damages be provided to investors in the event of a misrepresentation in the issuer's continuous disclosure record.

Sunset clause

Because the ASC, AMF and FCNB are proposing to adopt the exemption by rule, if implemented it is intended, subject to amendment, to be permanent. The other participating jurisdictions propose that the blanket order would expire on December 31, 2015, though it could be extended. They intend to monitor the use of the proposed exemption during this period to assess its usefulness for issuers, whether retail investors want to use it to acquire securities from the issuer rather than on the secondary market, and whether it provides sufficient protections for investors before proposing to make it a permanent rule.

Proposed form of exemption in local jurisdiction

Attached to this notice is the proposed blanket order or rule in the local jurisdiction.

Questions

We invite comment on all aspects of the proposed exemption. In particular, we would like to receive feedback in respect of the following questions:

1. If you are a TSXV issuer, will you use the proposed exemption?
2. Should the proposed exemption be available to issuers listed on other Canadian markets?
3. Investors will only be able to invest \$15,000 in a 12-month period unless they obtain advice from a registered investment dealer. Is \$15,000 the right investment limit?
4. In what circumstances would it be suitable for an investor that is a retail security holder to invest more than \$15,000 in a TSXV issuer?
5. Do you agree that there should be no investment limit if an investor receives suitability advice from a registered investment dealer?
6. Do you agree that being a current security holder of an issuer enables an investor to make a more informed investment decision in that issuer?

7. What is the appropriate record date for the exemption? Should it be one day before the announcement of the offering or should it be a more extended period? If you think it should be a more extended period, what would be the appropriate period of time?
8. We are currently proposing that the exemption be subject to the same resale restrictions as most other capital raising exemptions (i.e., a four month restricted period). However, there are some similarities between the proposed exemption and the rights offering exemption, which is only subject to a seasoning period.
 - a. Do you agree that a four month hold period is appropriate for this exemption?
 - b. Should we require issuers to provide additional continuous disclosure, such as an annual information form?
 - c. If we were to consider a seasoning period for this exemption, should we consider some of the restrictions that apply under a prospectus-exempt rights offering, such as “claw-backs” limiting insider participation?
 - d. If securities offered under the exemption were only subject to a seasoning period, would there be a greater need to ensure investors are made aware of and have an opportunity to participate in the offering?
9. We have not proposed any conditions regarding the structure of the financing, i.e., minimum or maximum price, maximum dilution, or period in which an offering must be completed. We contemplate that the proposed financing would be conducted under the standard private placement rules of the TSXV which, among other things, allow pricing at a discount to market price. Is this appropriate or are there structural requirements that we should make a condition of the exemption?

Comments

We are inviting comments until January 20, 2014.

Please submit your comments in writing. If you are sending your comments by email, please also send an electronic file containing the submissions in Microsoft Word.

Please address your comments to the following participating jurisdictions:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Prince Edward Island Securities Office
Office of the Yukon Superintendent of Securities

Office of the Superintendent of Securities, Government of the Northwest Territories
Legal Registries Division, Department of Justice, Government of Nunavut

Please send your comments only to the addressees below. Your comments will be forwarded to the other participating jurisdictions.

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Please note that comments received will be made publicly available and may be posted on the websites of the participating jurisdictions. We cannot keep submissions confidential.

Questions

Please direct your questions to any of the following:

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Local Rule 45-505

Prospectus Exemption for Distribution to Existing Security Holders

Definitions

1. Terms defined in National Instrument 14-101 *Definitions* or National Instrument 45-106 *Prospectus and Registration Exemptions* have the same meaning in this Instrument.
2. In this Instrument:
 - “announcement date” is the day that an issuer issues an offering news release;
 - “listed security” means a security of an issuer of a class of equity security listed on the TSX Venture Exchange;
 - “offering news release” means a news release issued by an issuer announcing its intention to conduct a distribution under section 3;
 - “record date” is the date that is • days prior to the announcement date;
 - “warrant” means a purchase warrant issued by an issuer that entitles the holder to acquire a listed security or a fraction of a listed security of the same issuer.

Exemption for sales to existing security holders

3. Subject to sections 4, 5, 6 and 7 the prospectus requirement does not apply to a distribution by an issuer of a security of its own issue to a security holder of the issuer if
 - (a) the issuer is a reporting issuer in at least one jurisdiction of Canada;
 - (b) the issuer's equity securities are listed for trading on the TSX Venture Exchange;
 - (c) the issuer has filed in each jurisdiction of Canada in which it is a reporting issuer all periodic and timely disclosure documents that it is required to have filed in that jurisdiction as required by each of the following,
 - i. applicable securities legislation,
 - ii. an order issued by the regulator or securities regulatory authority,

- iii. an undertaking to the regulator or securities regulatory authority;
 - (d) the issuer has issued and filed an offering news release;
 - (e) the distribution is of a listed security or a unit consisting of a listed security and a warrant;
 - (f) the purchaser represents in writing to the issuer that, on or before the record date the purchaser acquired and continues to hold, a listed security of the issuer of the same class and series as the listed security to be distributed under this section and neither the issuer nor any salesperson acting on behalf of the issuer in connection with the distribution has any reason to reasonably believe that the purchaser's representation is untrue;
 - (g) one of the following applies:
 - i. the purchaser is a person that has obtained advice regarding the suitability of the investment and, if that person is a resident in a jurisdiction in Canada, that advice has been obtained from a person that is registered as an investment dealer,
 - ii. the acquisition cost to the purchaser, when combined with the acquisition cost to the purchaser for the purchase of any other security from this issuer under this Instrument in the last 12 months, does not exceed \$15,000;
 - (h) the purchaser pays the acquisition cost in cash at the time of the distribution; and
 - (i) the purchaser purchases the security as principal.
4. The offering news release must include reasonable detail of the proposed distribution and proposed use of net proceeds including:
- (a) the minimum and maximum number of securities proposed to be distributed and the minimum and maximum aggregate gross proceeds of the distribution; and
 - (b) a description of the principal purposes with approximate amounts, for which the issuer will use the net proceeds, assuming both the minimum and maximum offering.
5. The subscription agreement must contain a certificate that:

- (a) states the following:

“The issuer’s documents and core documents, each as defined in section 161.1 of the *Securities Act* S.N.B. 2004, c. S-5.5, do not contain a misrepresentation. There is no material fact or material change related to the issuer which has not been generally disclosed.”; and

- (b) is signed by the chief executive officer and chief financial officer of the issuer or, in the case of an issuer that does not have a chief executive officer or chief financial officer, each individual that performs similar functions to those of a chief executive officer or chief financial officer.

Disclosure document

6. Other than the subscription agreement, any disclosure document provided to a purchaser in connection with a distribution under section 3 must be filed no later than the day that the material was first provided to a purchaser.

Resale restrictions

7. The first trade of a security acquired under section 3 is subject to section 2.5 of National Instrument 45-102 *Resale of Securities*.

Report of exempt distribution

8. An issuer that distributes a security under this Instrument must file a report of the distribution that complies with Form 45-106F1 *Report of Exempt Distribution* no later than 10 days after the distribution.

Application of statutory secondary market civil liability provisions to a purchaser under this Instrument

9. Part 11.1 of the *Securities Act* S.N.B. 2004, c. S-5.5 applies to a security distributed under section 3.